Federal Court of Appeal | Cour d'appel fédérale

CANADA

Date: 20110930

Docket: A-403-10

Citation: 2011 FCA 271

CORAM: **SHARLOW J.A.**
LAYDEN-STEVENSON J.A.
STRATAS J.A.

BETWEEN:

WAYNE CASSIDY

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Toronto, Ontario, on September 22, 2011.

Judgment delivered at Ottawa, Ontario, on September 30, 2011.

REASONS FOR JUDGMENT BY: SHARLOW J.A.

CONCURRED IN BY: LAYDEN-STEVENSON J.A.
STRATAS J.A.

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REASONS FOR JUDGMENT

SHARLOW J.A.

[1] This is an appeal of a judgment of the Tax Court of Canada (2010 TCC 471) dismissing an appeal by Mr. Wayne Cassidy of a reassessment under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) for the 2003 taxation year. The only issue is whether Mr. Cassidy is entitled to the benefit of the principal residence exemption in relation to the capital gain he realized in 2003 on the sale of his home and the 2.43 hectares of land on which it was located. For the reasons that follow, I have concluded that Mr. Cassidy was entitled to the exemption for the entire gain, and I would allow this appeal.

Facts

[2] The facts are undisputed and may be briefly summarized. In 1994, Mr. Cassidy and his then common law spouse acquired a house on a 2.43 hectare parcel of land near London, Ontario. In 1998, Mr. Cassidy became the sole owner of the property. He resided in the house on the property from 1994 until 2003, when the property was sold.

[3] In 1994 when Mr. Cassidy first acquired an interest in the property, he could not have acquired less than the 2.43 hectare parcel because of the zoning laws then applicable to the area in which the property was located. Those zoning laws remained unchanged until May 2, 2003, when an "Official Plan Amendment" came into force. Only then did it become open to Mr. Cassidy to apply to have the property rezoned and subdivided.

[4] In the spring of 2003, Mr. Cassidy was approached by a real estate agent who enquired as to whether his property was for sale. That led to an agreement dated May 23, 2003 in which Mr. Cassidy agreed to sell the property to Urban Properties Services (London) Inc. subject to certain conditions for the benefit of the purchaser, including a successful application for rezoning and subdivision. Mr. Cassidy authorized the purchaser to make the necessary applications, which were successful. The conditions were met and the sale of the property closed on November 27, 2003.

[5] Mr. Cassidy realized a capital gain on the sale but he did not report the gain when filing his 2003 income tax return because he believed that the entire gain fell within the principal residence

exemption. The Minister disagreed. Mr. Cassidy objected to the resulting reassessment, appealed to the Tax Court, without success, and now appeals to this Court.

Positions of the parties

[6] It is undisputed that when Mr. Cassidy sold the property in 2003, he became entitled to the principal residence exemption in respect of the gain he realized on the sale, at least in so far as the gain is allocable to the house and ½ hectare of the land on which the house was located. However, because his home was located on 2.43 hectares of land, there is an issue as to whether the principal residence exemption applies to the remaining 1.93 hectares.

[7] The position of Mr. Cassidy is that the entire 2.43 hectares of land was part of his principal residence from the date on which he acquired the property in 1994 until at least May 2, 2003, when a change to the local zoning bylaws would have permitted him for the first time to subdivide the land. On that basis, he argues that he is entitled to the principal residence exemption for the full amount of the gain.

[8] The position of the Crown is that the principal residence exemption does not apply to the 1.93 hectares of the land, and therefore the taxable capital gain allocable to that 1.93 hectares is subject to income tax. To give effect to that position, the Minister allocated Mr. Cassidy's capital gain between the 1.93 hectares and the house plus ½ hectare, and assessed tax on the taxable capital gain allocable to the 1.93 hectares. As I understand the record, there is now no controversy about the computation of the gain or the allocation of the gain in the event this appeal does not succeed.

[9] The Crown argues that Mr. Cassidy is not entitled to the principal residence exemption for the 1.93 hectares case because when he sold his property in November of 2003, he was no longer barred by local laws from subdividing the property. That makes a difference, in the Crown's submission, because it is only at the date of disposition of a property that one determines whether the ½ hectare rule applies at all. The Crown argues that if the ½ hectare test is not met on the date of disposition, then regardless of the facts on any earlier date, the taxpayer's principal residence cannot include more than ½ hectare of land. The Tax Court judge accepted this argument, and on that basis dismissed Mr. Cassidy's appeal.

Discussion

(a) Definition of principal residence

[10] "Principal residence" is defined in section 54 of the *Income Tax* Act for the purposes of the provisions relating to capital gains and losses (Part I, Division B, subdivision c). The portions of the definition that are relevant to this appeal are its opening words and paragraph (*e*) (the "½ hectare rule"). Those provisions read as follows:

54. In this subdivision, [...]	54. Les définitions qui suivent s'appliquent à la présente sous-section [...]
"principal residence" of a taxpayer for a taxation year means a particular property that is a housing unit, a leasehold interest in a housing unit or a share of the capital stock of a co-operative housing corporation acquired for the sole purpose of acquiring the right to inhabit a housing unit owned by the corporation and that	« résidence principale » S'agissant de la résidence principale d'un contribuable pour une année d'imposition, bien — logement, ou droit de tenure à bail y afférent, ou part du capital social d'une société coopérative d'habitation acquise dans l'unique but d'acquérir le droit d'habiter un logement dont la

is owned, whether jointly with another person or otherwise, in the year by the taxpayer, if [...]	coopérative est propriétaire — dont le contribuable est propriétaire au cours de l'année conjointement avec une autre personne ou autrement, à condition que : [...]
and, for the purpose of this definition	En outre, pour l'application de la présente définition :
(*e*) the principal residence of a taxpayer for a taxation year shall be deemed to include, except where the particular property consists of a share of the capital stock of a co-operative housing corporation, the land subjacent to the housing unit and such portion of any immediately contiguous land as can reasonably be regarded as contributing to the use and enjoyment of the housing unit as a residence, except that where the total area of the subjacent land and of that portion exceeds ½ hectare, the excess shall be deemed not to have contributed to the use and enjoyment of the housing unit as a residence unless the taxpayer establishes that it was necessary to such use and enjoyment.	*e*) la résidence principale d'un contribuable pour une année d'imposition est réputée comprendre (sauf si le bien est une part du capital social d'une société coopérative d'habitation) le fonds de terre sous-jacent au logement ainsi que la partie du fonds de terre adjacent qu'il est raisonnable de considérer comme facilitant l'usage du logement comme résidence; toutefois, dans le cas où la superficie totale du fonds de terre sous-jacent et de cette partie excède un demi-hectare, l'excédent n'est réputé faciliter l'usage du logement comme résidence que si le contribuable établit qu'il était nécessaire à cet usage.

[11] The definition of "principal residence" was enacted as part of the amendments that, for 1972 and subsequent years, made capital gains subject to income tax (S.C. 1970-71-72, c. 63). With one exception, the parts of the definition that are relevant to this appeal have not been substantially changed since 1972. The one exception relates to what is now paragraph (*e*) of the definition. For

dispositions before 1982, the reference to "½ hectare" was "one acre" (S.C. 1980-81-82-83, c. 140, subsections 23(4) and (10)).

[12] The aspect of the definition of "principal residence" that is most relevant to this case is the ½ hectare rule. It applies where the housing unit for which the principal residence exemption is claimed sits on land in excess of ½ hectare. In such a case, ½ hectare of the land is deemed to be part of the principal residence, but the excess land is deemed not to be part of the principal residence unless the taxpayer proves that excess was necessary to the use and enjoyment of the housing unit as a residence.

[13] As stated above, the property for which Mr. Cassidy has claimed the principal residence exemption consists of a house and 2.43 hectares of land. Mr. Cassidy resided there from the date of its acquisition in 1994 to the date it was sold in November of 2003. In 1994, when Mr. Cassidy acquired the property, local zoning by-laws precluded him from acquiring less than the entire 2.43 hectares of land.

[14] The Minister has not taken the position that the house and the entire 2.43 hectares did not become Mr. Cassidy's principal residence when he acquired it in 1994. In my view, such a position would be untenable because Mr. Cassidy's situation was indistinguishable from the situation of the taxpayer in *Canada v. Yates*, [1983] 2 F.C. 730, (F.C.T.D.), described as follows by Justice Mahoney:

> The defendants could not legally have occupied their housing unit as a residence on less than ten acres. It follows that the entire ten acres, subjacent and contiguous, not only "may reasonably" be regarded as contributing to their use and enjoyment of their housing unit as a residence; it must be so regarded. It also follows that the portion in excess of one acre was necessary to that use and enjoyment.

Justice Mahoney's decision was affirmed by this Court, [1986] 2 C.T.C. 46; 86 D.T.C. 6296, and has been consistently followed by this Court in similar circumstances: see *Augart v.Canada (Minister of National Revenue)*, [1993] 3 F.C. 296 (F.C.A.), and *Carlile v. Canada (Minister of National Revenue)*, [1995] 2 C.T.C. 273. 95 D.T.C. 5483 (F.C.A.).

[15] This would suggest that as long as the zoning remained what it was in 1994 and there were no other relevant facts, the entire 2.43 hectares of land would have been Mr. Cassidy's principal residence until May 2, 2003, when the zoning changed.

[16] However, as indicated above, the Crown's position is that if the ½ hectare test is not met on the date of disposition, then it does not matter whether it was met at any earlier date. As I understand that argument, it raises no question as to the interpretation of the statutory definition of "principal residence". Rather, it relates to the application of paragraph 40(2)(*b*) of the *Income Tax Act*, which is discussed in the next part of these reasons.

(b) Determining the capital gain on the disposition of a principal residence

[17] Gains realized on the disposition of capital property have been subject to income tax since 1972, but there have always been numerous exceptions. One such exception is found in paragraph

40(2)*(b)* of the *Income Tax Act*, referred to as the "principal residence exemption". Paragraph *40*(2)*(b)* sets out a special formula for determining the capital gain on the disposition of any property that was the taxpayer's "principal residence" at any time after its acquisition. It reads in relevant part as follows.

40. (2) …	**40**. (2) […]
(b) where the taxpayer is an individual, the taxpayer's gain for a taxation year from the disposition of a property that was the taxpayer's principal residence at any time after the date (in this section referred to as the "acquisition date") that is the later of December 31, 1971 and the day on which the taxpayer last acquired or reacquired it, as the case may be, is the amount determined by the formula	*b*) dans le cas où le contribuable est un particulier, le gain qu'il a tiré, pour une année d'imposition, de la disposition d'un bien qui était sa résidence principale à un moment donné après le jour (appelé « date d'acquisition » au présent article) qui est le dernier en date du 31 décembre 1971 et du jour où il a acquis le bien, ou l'a acquis de nouveau, pour la dernière fois correspond au résultat du calcul suivant :
A - (A × B/C) - D	**A - (A × B/C) - D**
where	où :
A is the amount that would, if this Act were read without reference to this paragraph and subsections 110.6(19) and 110.6(21), be the taxpayer's gain therefrom for the year,	**A** représente le montant qui constituerait le gain du contribuable provenant de la disposition pour l'année, compte non tenu du présent alinéa et des paragraphes 110.6(19) et (21),
B is one plus the number of taxation years that end after the acquisition date for which the property was the taxpayer's principal residence and during which the taxpayer was resident in Canada,	**B** le nombre un plus le nombre d'années d'imposition qui se terminent après la date d'acquisition pour lesquelles le bien était la résidence principale du contribuable et au cours desquelles celui-ci résidait au Canada,

C is the number of taxation years that end after the acquisition date during which the taxpayer owned the property whether jointly with another person or otherwise, and	**C** le nombre d'années d'imposition se terminant après la date d'acquisition au cours desquelles le contribuable était propriétaire du bien conjointement avec une autre personne ou autrement,
D ….	**D** […]

[18] The opening words of this provision ask whether Mr. Cassidy realized a gain in 2003 on any property that was his principal residence at any time after he acquired it. Whether or not his principal residence extends to the entire 2.43 hectares of land, the answer is yes. Therefore, Mr. Cassidy is entitled to the benefit of this provision. What the benefit is worth to Mr. Cassidy depends upon the statutory formula.

[19] The formula has 4 variables of which the fourth (variable D) is not relevant in this case and can be ignored.

[20] Variable A is the amount of Mr. Cassidy's gain from sale of the property. There is no controversy as to the amount.

[21] The part of the formula in parentheses, (A × B/C), is the exempt portion of capital gain. In the factual context of this case, variable C is the number of years from 1994 to 2003, because that is the number of years in which Mr. Cassidy owned the property in issue.

[22] Variable B is 1 plus (and here I paraphrase) the number of years in which the "principal residence" definition is met. If variable B equals variable C, then the result of the formula would be zero, meaning that the entire gain would be exempt.

[23] The language describing variable B requires a determination, for each taxation year in which the property in issue was owned by the taxpayer claiming the exemption, whether the property met the statutory definition of "principal residence". That definition refers in both the opening words and paragraph (*e*) to the principal residence of a taxpayer "for a taxation year". That is consistent with the requirement in the charging provision, paragraph 40(2)(*b*), for an annual determination.

[24] Where, as in this case, there is an issue as to whether land in excess of ½ hectare is part of the principal residence, it is useful to apply the formula in two stages, first to the portion of the gain that is allocable to the sale of the house and the ½ hectare of land that comprises the principal residence, and then to the portion of the gain that is allocable to the excess. The allocation for this case is not disclosed in the record but it is apparently not in dispute. I will simply assume that the total capital gain is $100,000, the portion of the gain attributable to the house and ½ hectare of land is $60,000, and the portion attributable to the remaining 1.93 hectares of land is $40,000.

[25] Not surprisingly, the application of the formula in paragraph 40(2)(*b*) results in the gain allocable to the house and the ½ hectare of land being entirely exempt. That is because variable B is 11 (that is, 1 plus the total number of years for which the house and the ½ hectare of land was Mr.

Cassidy's principal residence, which was 1994 and every subsequent year to and including 2003). The formula gives this result:

$60,000 - ($60,000 × 11/10) = – $6,000

The arithmetic result of the formula is a negative amount, - $6,000 (which is deemed by section 257 of *the Income Tax Act* to be zero). Therefore, paraphrasing the opening words paragraph 40(2)(*b*), Mr. Cassidy's gain for 2003 from the disposition of the house and ½ hectare of land is zero.

[26] For the remaining 1.93 hectares of land, the formula yields the same result. That is because for that 1.93 hectares, variable B is 10. As explained above, the 1.93 hectares was part of Mr. Cassidy's principal residence in 1994 when it was first acquired, until May 2, 2003 when the zoning changed. Assuming without deciding that 2003 should be disregarded, the number of years for which the 1.93 hectares of land was deemed to be included as part of Mr. Cassidy's principal residence was 9 (1994 and every subsequent year to and including 2002). Variable B is 1 plus 9, or 10. The result of the formula is:

$40,000 - ($40,000 × 10/10) = 0

[27] Thus, on the interpretation of paragraph 40(2)(*b*) proposed by Mr. Cassidy, he is entitled to the principal residence exemption for the full amount of the gain realized on the sale of his house and the entire 2.43 hectares.

[28] The Crown argues against this interpretation and says that it is not necessary for the purpose of paragraph 40(2)(*b*) to determine for each year of ownership whether the 1.93 hectares of land is

included in Mr. Cassidy's principal residence. Rather, the Crown argues that this determination is required only for the date on which the property is disposed of. In support of that position, the Crown relies on *Yates* (cited above), *Stuart Estate v. Canada*, 2004 FCA 80, and *Joyner v. Minister of National Revenue*, [1989] 1 F.C. 306 (F.C.T.D.).

[29] The issue in *Yates* was whether 9.3 acres of a 10 acre parcel of land met the statutory definition of "principal residence". The taxpayers had purchased a 10 acre parcel of land at a time when zoning by-laws precluded any subdivision. They built a house on the property in 1964, and lived there at all relevant times. In 1978 they sold 9.3 acres of the land (not including the portion on which their house was located) to a municipality under threat of expropriation. Justice Mahoney concluded that the entire 9.3 acres met the statutory definition of "principal residence". In reaching that conclusion he said, "In my opinion, the critical time is the moment before disposition." However, it is not clear why he said that because there was no suggestion in the case that facts relevant to the determination of the principal residence exemption had changed at any time between the date on which the taxpayers bought the property and the date on which the 9.3 acres was expropriated. There was no discussion of paragraph 40(2)(*b*) or its statutory predecessor (which was substantially the same).

[30] In *Stuart Estate*, Justice Malone (writing for this Court) said at paragraph 9, "It is common ground that the relevant time for determining how much of the land in excess of ½ hectare (1.235 acres) was necessary to the use and enjoyment of the housing unit as a residence is the time of the disposition." *Yates* is cited for this proposition. However, the facts in *Stuart Estate* that were

relevant to the determination of the principal residence exemption had not changed during the period in which the property was owned by the taxpayer, and so there was no controversy to be resolved except the application of the ½ hectare rule, and no consideration of paragraph 40(2)(*b*).

[31] In my view, the statements from *Yates* and *Stuart Estate*, read in context, do not support the proposition for which they are cited by the Crown. Neither case involved any consideration of paragraph 40(2)(*b*), no doubt because neither case involved a situation in which the facts relevant to the application of the ½ hectare rule changed during the period in which the property in issue was owned by the taxpayer. Therefore, neither case was intended to determine the issue that has arisen in this case.

[32] The Crown mentioned, as a case favouring Mr. Cassidy, *Raper Estate v. Canada (Minister of National Revenue - M.N.R.)*, [1986] 2 C.T.C. 2052, 86 D.T.C. 1513 (T.C.C.). In that case, Justice Tremblay allowed the principal residence exemption in part, based on facts that were similar to the facts of this case in that from 1971 to 1980, zoning laws prohibited any severance of the land on which the taxpayer's home was located. That changed in 1980 so that in 1982, when the property was sold, a severance was possible. In allowing a partial exemption, Justice Tremblay recognized that the formula in paragraph 40(2)(*b*) required an annual determination of the principal residence exemption.

[33] However, the Crown also relies on *Joyner v. Minister of National Revenue*, [1989] 1 F.C. 306 (F.C.T.D.), in which Justice Reed declined to apply the reasoning in *Raper Estate*. In *Joyner*,

the taxpayer argued unsuccessfully that he should be entitled to the principal residence exemption for part of the gain realized on the sale of 7.9 acres of a 14 acre parcel on which his home was located. The 7.9 acre parcel included the house, and the Minister allowed the principal residence exemption for the house plus one acre. As to the remaining 6.9 acres, Mr. Joyner argued that although he could have subdivided the land during most of the period of ownership (1968 to 1980), there was a four year period in the 1970s during which subdivision was prohibited by a provincial law, and for that period the reasoning in *Yates* should be applied in respect of those four years. Justice Reed rejected that argument and found that the principal residence exemption did not apply at all to the 6.9 acres in issue.

[34] It is arguable that *Joyner* could be taken as authority for the proposition that paragraph 40(2)(*b*) does not require a determination as to whether the definition of principal residence is met for each year of ownership. If that is the *ratio decidendi* of the case, then in my respectful view the case is wrong and should not be followed.

[35] The error in the interpretation of paragraph 40(2)(*b*) proposed by the Crown, and perhaps implicit in *Joyner*, is that it fails to give effect to the language of paragraph 40(2)(*b*) that defines variable B. As mentioned above, the determination of variable B requires a determination, for each taxation year in which the taxpayer owned the property in issue, as to whether the property met the definition of “principal residence” of the taxpayer <u>for that taxation year</u>.

[36] On the other hand, the interpretation of paragraph 40(2)(*b*) proposed by Mr. Cassidy is consistent with its language and its purpose. In broad terms, the purpose of paragraph 40(2)(*b*) is to relieve individuals from the obligation to pay tax on the capital gain realized on the sale of their principal residence. The annual determination mandated for variable B in the formula in paragraph 40(2)(*b*) is intended to ensure that the benefit of the principal residence exemption is allowed in part in the case of property that, for any reason, does not meet the definition of "principal residence" for the entire period of ownership.

Conclusion

[37] For these reasons, I would allow the appeal of Mr. Cassidy, set aside the judgment of the Tax Court of Canada, allow the appeal of the 2003 reassessment, and refer this matter back to the Minister for reassessment on the basis that Mr. Cassidy is entitled to the benefit of the principal residence exemption for the full amount of his capital gain realized on the sale of his house and the 2.43 hectares of land. Mr. Cassidy is entitled to his costs in this Court and in the Tax Court.

"K. Sharlow"

J.A.

"I agree
Carolyn Layden-Stevenson J.A."

"I agree
David Stratas J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-403-10

AN APPEAL FROM AN ORDER OF THE HONOURABLE MR. JUSTICE RÉAL FAVREAU OF THE TAX COURT OF CANADA, DATED JANUARY 27, 2011, IN COURT FILE NO.: 2008-630(IT)G.

STYLE OF CAUSE:	WAYNE CASSIDY v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, ON
DATE OF HEARING:	September 22, 2011
REASONS FOR JUDGMENT BY:	Sharlow J.A.
CONCURRED IN BY:	Layden-Stevenson J.A. Stratas J.A.
DATED:	September 30, 2011

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